HOUSING MARKET OUTLOOK

Sherbrooke

Canada Mortgage and Housing Corporation

www.cmhc.ca

SPRING-SUMMER 2005

Highlights

✓ The resale market will not lose any of its vigour. This market will remain at its peak in terms of transactions and will even rise above the range where it has been for the last few years. Prices will sustain a fourth marked increase (10 per cent or greater) in 2005. Even if affordability is declining, many households still have some room to adjust to the rise in prices. In Canada, only 20 per cent of low-income homeowners (<$40,000) have a variable-rate mortgage, a percentage that would appear to be much lower than in the United States[1].

✓ Housing starts, for their share, will decline, but mainly because of a slowdown in the production of apartments intended for the rental market, as the more expensive apartment niche ($700 or more per month) runs out of steam. The construction of freehold homes will stay in the range of 550 to 600 units, which is high for the area.

✓ Unoccupied rental housing units will remain scarce, even if the market will ease slightly. The vacancy rate will stay below 1.5 per cent over the forecast period. Immigration will continue to be the main driving force behind the new demand for rental housing.

Climate to remain conducive to buying new or existing homes in 2005 and 2006

✓ The decision to buy a home or not largely rests on employment, income and family status. A steady job, an average family income and the presence of children, for example, are factors that predispose households to make such a purchase. In addition to the family's financial situation, mortgage rates affect the choice of what will be purchased: semi-detached or two-storey, city or suburbs, affordable or luxury, number of bathrooms, with or without a garage?

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[1] "Loonie Boom", *CIBC World Markets*, by Benjamin Tal, March 15, 2005.

Canada

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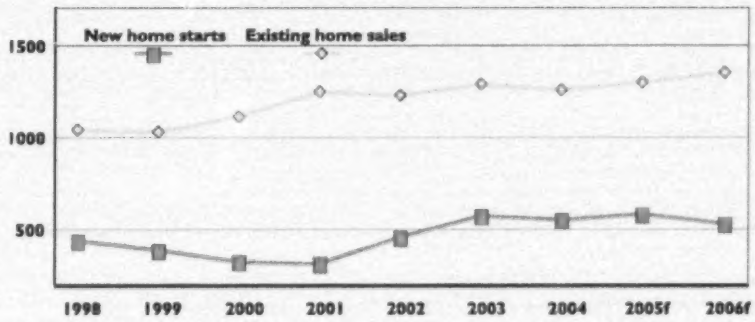
HOME TO CANADIANS

✓ The fundamental factors for home buying decisions will remain favourable over the forecast horizon. First, employment went up last year in the Sherbrooke census metropolitan area (2,175 jobs) and will continue to do so. Capital spending posted a gain in 2004, and the job losses in the manufacturing sector and, as a result, in the transportation sector, now seem to be largely behind us. Second, family disposable income remains on the upward course that began in 1997, according to the Statistics Canada estimate. The strong employment growth among people aged from 45 to 64 years in 2004 will support demand for homes on the part of experienced buyers.

Good Years in Sight for Home Demand
Sherbrooke CMA



Sources: Chambre immobilière de l'Estrie and CMHC f: forecasts

✓ The scarcity of unoccupied rental housing (228 units in October 2004) is also contributing to the continued favourable climate for home buying. This result is amplified by the fact that around one third of the vacant units command high rents, which are close to average monthly mortgage payments.

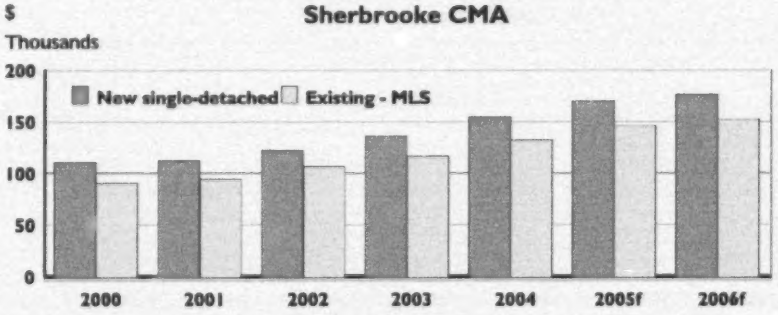
✓ Mortgage rates will stay low, as they will remain almost the same this year and rise by around 50 basis points in 2006. However, the increase in the posted mortgage rates will not necessarily affect the rates negotiated between borrowers and lenders. In recent years, the spread between the mortgage rate and the bond rate for a comparable term has remained in the range from 2.0 to 2.5 percentage points, which has allowed lenders to grant discounts varying between 0.5 and 1.5 percentage points on posted rates. These spreads and discounts should be maintained in the short term.

✓ The slow rise in mortgage rates will reduce the negative impact of the strong increase in both new and existing home prices. Increasingly flexible credit options and the introduction of new products are also facilitating the adjustment. Gifts from parents to children and inheritances might also be expected to be among the adjustment factors, as well.

✓ The decrease in consumer confidence and the increase in bankruptcies in Quebec could be assumed to be toning down the generally favourable climate for home buying. However, this effect is still modest as, even if 27 per cent of Quebec residents are expecting a drop in their buying power, three times as many of them as last year are planning to buy a home in 2005[2]. The negative impact of the decrease in confidence could therefore be limited to the upscale market, generally the first segment to be affected by a turnaround in the trend. As for bankruptcies, while they may have risen by 3 per cent in 2004 in Quebec, they are still far, at 23,166, from the peak of 26,970 registered in 1997.

[2] *Les Affaires*, March 19th 2005, p. 40.

Home Prices Have Not Yet Reached a Peak
Sherbrooke CMA



Sources: Chambre immobilière de l'Estrie and CMHC f: forecasts

✓ Existing home sales recorded through the Service inter-agences / Multiple Listing Service (S.I.A.® / MLS®) will rise slightly in 2005 and 2006. After having reached a level of 1,264 units in 2004, transactions will attain 1,300 units in 2005 and then 1,350 units next year. As a result, in 2006, existing home sales will rise above the range from 1,200 to 1,300 units, where they had been hovering for the last four years on account of the limited supply of homes for sale. This level therefore assumes that supply will increase over the coming months, which will allow for a small hike in sales and a slower rise in prices in 2006. The increase in the average price of existing homes will be 10 per cent in 2005 and then slow down to 4 per cent in 2006, which will bring the average price to $152,000.

✓ Given that the existing home market cycle usually precedes the new home market cycle and that the price increase acts as a transmission belt between the two, starts will post a small gain in 2005, as they will go up from 554 units in 2004 to 590 units this year. In 2006, home building will sustain only a marginal decrease, to 540 units. The average value of new homes will be $15,000 greater than the level observed last year, which will bring the average price of new single-detached houses to $171,000.

Apartment construction begins to decline

✓ Apartment starts made a significant jump in 2004, to 801 units, a level attained or exceeded only ten times since 1973, the first year for which data is available. Out of this total, 82 per cent of the units were intended for the rental market and 16 per cent, for the condominium market. The remaining 2 per cent of these dwellings took the form of duplexes intended for homeowners.

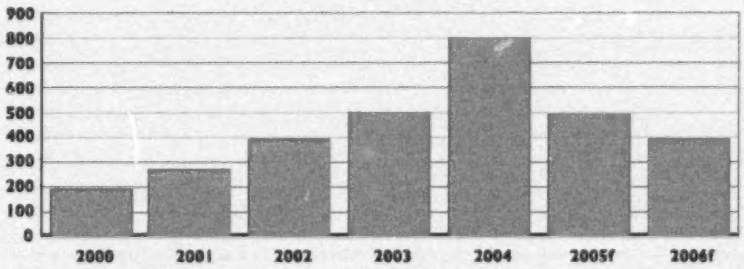
✓ From 1973 until the mid-1980s, rental housing demand was strongly stimulated by the arrival of the baby boomers on the housing market. In recent years, immigration has been the main factor contributing to the increase in rental housing demand. Around 1,000 immigrants settle in the area every year. Since employment performance influences the destination of immigrants, the level of newcomers should be maintained over the forecast period, as the job pool is expected to grow in Sherbrooke. It is estimated that 74 per cent of new immigrants opt for the rental market when they arrive. The migration of about a hundred people aged 65 years or older from rural areas to Sherbrooke every year and the recent improvement in employment for the 15-24 years' age group are also helping to support rental housing demand.

✓ The rental market survey conducted in October 2004 revealed that vacancy rates have risen for newer buildings (to 4 per cent) and units renting for $700 or more (6 per cent), as a result of the rapid rise in apartment construction since 2002, in a context of higher construction costs. Production will therefore begin to decline in 2005. From 801 apartments in 2004, this production will fall to 490 units in 2005 and then to 390 units in 2006.

✓ Even with the arrival of many new apartments and the strength of the homeownership trend, the rise in the overall vacancy rate will be limited (from 0.9 per cent to 1.4 per cent), on account of the vigorous rental housing demand, the causes of which are discussed above. Since production is slowing down, the vacancy rate should go back down slightly in 2006, to 1.2 per cent.

✓ With the addition of expensive rental housing units, the proportion of young people staying with their parents is bound to grow. In 2001, 25.6 per cent of people aged from 20 to 29 years in the Sherbrooke area lived with their parents. Since there were 54.0 per cent in Toronto, 39.1 per cent in Montréal, 37.7 per cent in Québec and 38.3 per cent in Trois-Rivières, it would not be surprising to see this proportion increase in Sherbrooke, all the more so since the price of homes is on the rise, another factor contributing to the delay in leaving the family home. In addition to enjoying a larger discretionary income, young Sherbrooke residents could want to maintain their employment mobility in order to be able to move away in view of raising their income expectations, especially if they have a university degree. In 2000, family providers with this qualification earned an average of $39,358 in Sherbrooke, compared to

Apartment Starts Begin to Decline
Sherbrooke CMA



Source: CMHC f: forecasts

$45,834 across Quebec and $48,648 in the rest of Canada.

✓ The production of apartments intended for the condominium market was vigorous last year in the area, with 129 units, an unprecedented level. Between the aging baby boomers, varying lifestyles, increasing real estate prices and rising construction costs, condominiums have managed to raise their market share. But since this niche is limited to Sherbrooke, production will slow down to 80 units in 2005 and then to 30 units in 2006. Just like for freehold homes, the price of condominiums is also on the rise. Between 2003 and 2004, the average price of condominiums sold through the S.I.A.® / MLS® rose from $116,300 to $128,100, for an increase of 10 per cent.

How long will it be possible to build housing adapted to the needs of seniors?

While this question may seem strange at first, it soon becomes relevant after thinking about it for a few moments.

Over the long term, housing demand is dependent on demographics. As long as household formation will be positive from one year to the next, there will be a need for more housing since, by definition, one household corresponds to one inhabited dwelling. In the context of a falling birth rate and a possible decrease in the population in the long term, will the need for new housing come to an end one day?

The Institut de la statistique du Québec (ISQ), which provides demographic projections, anticipates that the number of households will continue to grow in the Sherbrooke CMA over its entire analysis period, that is, until 2026. There would consequently not be any reason for residential construction to stop during this period in Sherbrooke.

However, the ISQ data indicates that housing production is bound to decline significantly. In fact, this provincial agency has estimated the number of new households in the area at 1,310 for 2004, compared to just 342 at the end of the forecast horizon. It should therefore be expected that residential construction will slow down considerably over the long term, failing which the number of unoccupied dwellings will increase.

During the forecast period, the formation of households aged 75 years or older will pick up the pace, rising from 174 per year in 2004 to 511 per year in 2026. At that time, total household formation will be only 342 for the Sherbrooke CMA overall.

If new housing production follows total household formation, the housing stock will be renewed at a slower pace than the growth in senior households, as 342 new dwellings would be built while 511 households aged 75 years or older would be added. Since people aged 75 years or older often require dwellings adapted to their needs as they get frail, it has to be questioned whether it will be possible to fully meet the growing demand for such units with the new housing production. If not, it may be necessary to renovate the existing housing stock, which sometimes represents a major challenge (installing an elevator, widening hallways and doorways, undertaking conversions, etc.). Also, buyers of new homes who intend to live in them for a long time, be they apartments, condominiums or houses, would do well to plan the adaptation of their property, right from the construction stage.

Projected Household Growth According to the Institut de la statistique du Québec
Sherbrooke CMA - Reference Scenario

Year	Total	75 years or older
2005	1,226	204
2006	1,082	189
2007	954	193
2008	900	164
2021	536	474
2022	497	515
2023	425	503
2024	427	557
2025	402	523
2026	342	511

It is around 2021-2022 that senior household formation will catch up with total household formation. From then on, the margin available to develop housing adapted to the needs of the many seniors will be reduced considerably. This is why the next 15 years will be the prime period to build housing that will meet the needs of an aging client group, when they will arrive on the market.

FORECAST SUMMARY
Sherbrooke Census Metropolitan Area
Spring-Summer 2005

	2004	2005f	% Chg.	2006f	% Chg.
RESALE MARKET					
MLS® sales	1,264	1,300	3%	1,350	4%
Average MLS® price ($)	133,700	146,700	10%	152,000	4%
NEW HOME MARKET					
Starts - by intended market					
Total	1,355	1,080	-20%	930	-14%
Freehold	571	600	5%	550	-8%
Rental	655	400	-39%	350	-13%
Condominium	129	80	-38%	30	-63%
Average price ($)					
Single-detached houses	156,000	171,000	10%	176,000	3%
RENTAL MARKET					
Vacancy rate (%)	0.9	1.4	n.a.	1.2	n.a.
Rent (2-bedroom) ($)	495	510	3%	525	3%
ECONOMIC OVERVIEW					
Mortgage rate - 3-year (%)	5.7	5.8	n.a.	6.3	n.a.
Mortgage rate - 5-year (%)	6.2	6.3	n.a.	6.7	n.a.
Employment level	81,825	82,825	1%	83,925	1%
Employment growth (number)	2,175	1,000	n.a.	1,100	n.a.

f: CMHC forecasts
Sources: CMHC and Statistics Canada

For more information about this publication, please contact our:

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